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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Economic Situation in South Vietnam

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
February 1972

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

Highlights

1. Just before Tet (15-17 February) Saigon enacted several stabilization measures affecting tax and exchange rates and government spending. The measures are designed to generate additional revenues and reduce subsidies. The piaster was also devalued by a small amount simply to establish that exchange rates are indeed flexible.
2. The 1972 budget calls for a 20% increase in expenditures and a 27% increase in revenues. As in the past, the large deficit will be financed by borrowing from the banking sector.
3. Money supply increased sharply in December as the result of the usual yearend increase in government spending combined with an extremely high level of US purchases of piasters for local expenditures. For the year as a whole, US piaster purchases were at a record high, but the money supply did not expand as much as past experience would have suggested, because of the success of various economic reforms adopted by the GVN.
4. Saigon retail prices rose 10% during the three weeks before Tet, but declined the following week to yield an increase for the year to date (21 February) of 6.6%. Apparently reflecting concern aroused by the Nixon and Thieu peace proposals and forecasts of an enemy offensive, the black market price of dollars increased sharply in late January and fluctuated at a relatively high level through 21 February.
5. Charts on foreign exchange reserves, money supply and prices, import licensing, gold and currency prices, and the government budget follow the text.

Note: This memorandum was prepared by the Office of Economic Research.

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Discussion

Stabilization Measures

6. Continuing its recent practice of making periodic adjustments in economic policy, the government enacted several stabilization measures affecting tax and exchange rates and public spending just before Tet (15-17 February). Although the measures should tend to reduce the budget deficit by generating additional revenues and reducing subsidies, their net effect cannot yet be estimated. Because the measures also will result in higher prices for many commodities, the government chose to move quietly when most Saigon newspapers had already closed for the Tet holidays.

7. The primary source of increased revenues in the pre-Tet package will be higher taxes on petroleum products. The official prices of gasoline and kerosene will increase 36% and 45%, respectively. Tax increases on tobacco, beer, and soft drinks were enacted in mid-January.

8. In order to activate the policy of flexible exchange rates announced last November, the government devalued import exchange rates by 5 piasters. Thus the rate for US-financed imports rose from 275 to 280 piasters per dollar and the rate for GVN-financed imports from 400 to 405 piasters per dollar. Realizing that the longer they delayed the greater the resistance would be to changing the rates, officials decided to act without waiting for the final National Assembly action on exchange rate legislation submitted last November.

9. The only other change in exchange rates was to reduce the subsidy that farmers have been receiving through access to an artificially low exchange rate for imports of fertilizer and pesticides. These commodities will now come in at the rate of 200 rather than 118 piasters per dollar. Agricultural specialists are not sure how much this will affect farmers' production costs, since importers and middlemen reportedly have been reaping most of the benefits of the low exchange rate up to this point.

10. Finally, the subsidy on government rice sales in Military Regions 1 and 2 was reduced for the fourth time in the last 18 months. The government plans to phase itself out of the commercial rice market in the northern provinces, but will continue to pay private merchants for the cost of transporting rice from the Delta to MRs 1 and 2. Thus, with the exception of transport costs, rice prices for most consumers in the north will be determined by market prices for the first time in several years.

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Government stocks, however, will continue to supply military needs and probably those of the civil service at somewhat below the market price.⁽¹⁾

1972 Budget

11. The 1972 budget, which should be approved shortly by President Thieu, sets total expenditures 20% higher than in 1971 (324 billion piasters, or \$790 million at the financial market exchange rate of 410 piasters per dollar). Both military and civilian spending are expected to increase at about the same rate. No detailed breakdown is available, but personnel costs probably account for at least two-thirds of total expenditures. Since 1968 the military budget has more than doubled,⁽²⁾ while civilian spending has more than tripled (see chart following the text).

12. Revenues are expected to cover about 85% of expenditures,⁽³⁾ or slightly more than estimated for 1971. The deficit will be covered by borrowing from the banking sector (primarily the National Bank of Vietnam). Domestic taxes – such as those on income, property, and business activities – will provide only about 30% of revenues. As in the past, the US foreign aid program is clearly the most important source of revenues. These revenues have come either from the sale of foreign exchange provided through US-financed import programs or from customs duties on goods imported with this foreign exchange. The tariff reform of November 1971 will result in a reduction of revenue from customs duties this year. This reduction, however, will be more than offset because the devaluations of November 1971 and February 1972 will result in more piasters for the sale of each dollar and a new grant aid fund will be established to replace the foreign exchange lost to the GVN as US forces withdraw and their requirements for piasters decline.⁽⁴⁾ In the long run, however, as the US reduces its aid, the GVN will have to rely increasingly on domestic taxes to provide revenues.

Money Supply

13. There was a sharp increase in the money supply in December 1971 because the normal yearend increase in government spending was

1. The government currently supplies rice to the armed forces nationwide and to civil servants everywhere except in MR 4. Only in MRs 1 and 2 has the government been heavily involved in the commercial market.
2. The GVN budget does not reflect those defense expenditures paid for by US military aid, which has been roughly \$2 billion annually for several years.
3. Revenue targets, however, probably will change as the result of recent tax and exchange rate measures (see paragraphs 6-10).
4. The new grant aid fund, called the Economic Support Fund, will not increase total US aid to South Vietnam.

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combined with an unusually large increase in holdings of foreign exchange. Money supply jumped 9% in December to yield a 28% increase for the year, compared with increases of 13% and 16% in 1969 and 1970, respectively. Foreign exchange reserves rose from \$213 million to \$242 million as the US Government bought a record high \$54 million worth of piasters in December to strengthen official balances and meet individuals' demands for piasters for Christmas spending. There also was a sizable increase in loans to the private sector, but this increase was more than offset by the increase in savings and time deposits and deposits related to import orders. Licensing for imports financed through the US Commercial Import Program rose sharply in late December with talk of a reduction in US aid for this fiscal year.

14. For 1971 as a whole, US piaster purchases were at a record high, but the money supply did not expand as much as past experience would indicate, because of the success of various economic reforms adopted by the GVN over the past 18 months. The United States purchased 74 billion piasters for both official and personal in-country expenditures in 1971, compared with only 41 billion piasters in 1970. Almost the entire increase was due to higher spending by individuals, even though the number of US personnel in Vietnam declined. During 1971 there was a massive shift in personal conversions of foreign exchange from the black market to official channels. In addition, the higher exchange rates for personal conversions made domestic goods and services more attractive.⁽⁵⁾ Piaster purchases, however, will decline in 1972 as more US forces are withdrawn and US military reconstruction of Vietnam's road network is completed.

15. The money supply probably increased again in January when government spending was, as usual, at a high level because of Tet bonuses. Data are not yet available to confirm the increase, but it is known that US piaster purchases -- off somewhat from December -- were still at a relatively high level.

Prices

16. Prices rose sharply in Saigon during the three weeks before the Tet holidays (15-17 February) but declined the following week. The USAID index, which had risen 10% during the pre-Tet period, fell 3.4% the week ending 21 February to yield an increase for the year to date of 6.6%. The price increase before Tet was in line with those of the past two Tet holiday periods, but was spread evenly throughout the period rather than being

5. The exchange rate for personal currency conversions (the so-called accommodation rate) was raised in October 1970 from 118 to 275 piasters per dollar and in November 1971 to 410 piasters per dollar.

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concentrated in the final week as in the past. Embassy officials attribute the earlier than usual price increases to uncertainties created by the Nixon and Thieu peace proposals of late January and the forecasts of increased enemy military activity during Tet. Food prices, which had risen 9% during the three weeks before Tet, fell only 1% following Tet primarily because deliveries of some commodities were down due to the holidays. On the other hand, prices of nonfood items, which rose 12% before Tet, dropped 10% during the week ending 21 February.

Currency Black Market

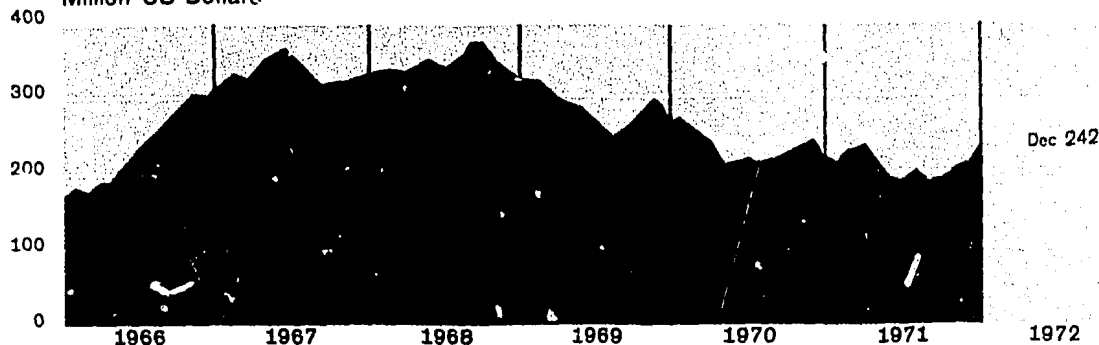
17. The black market rate for dollars, usually relatively stable before Tet, jumped sharply at the end of January and then fluctuated at a high level through 21 February. The same uncertainties surrounding commodity markets in late January probably affected the currency market as well. The Saigon dollar rate, which had been quite stable for several weeks at about 415 piasters per dollar, jumped to 432 piasters by 7 February and closed on 21 February at 429 piasters per dollar. The price of gold leaf followed much the same pattern during the period. The rate of MPC (scrip) followed no particular pattern except that it continued to stay well below the legal rate of 410 piasters per dollar.

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SOUTH VIETNAM

Foreign Exchange Reserves*

Million US Dollars



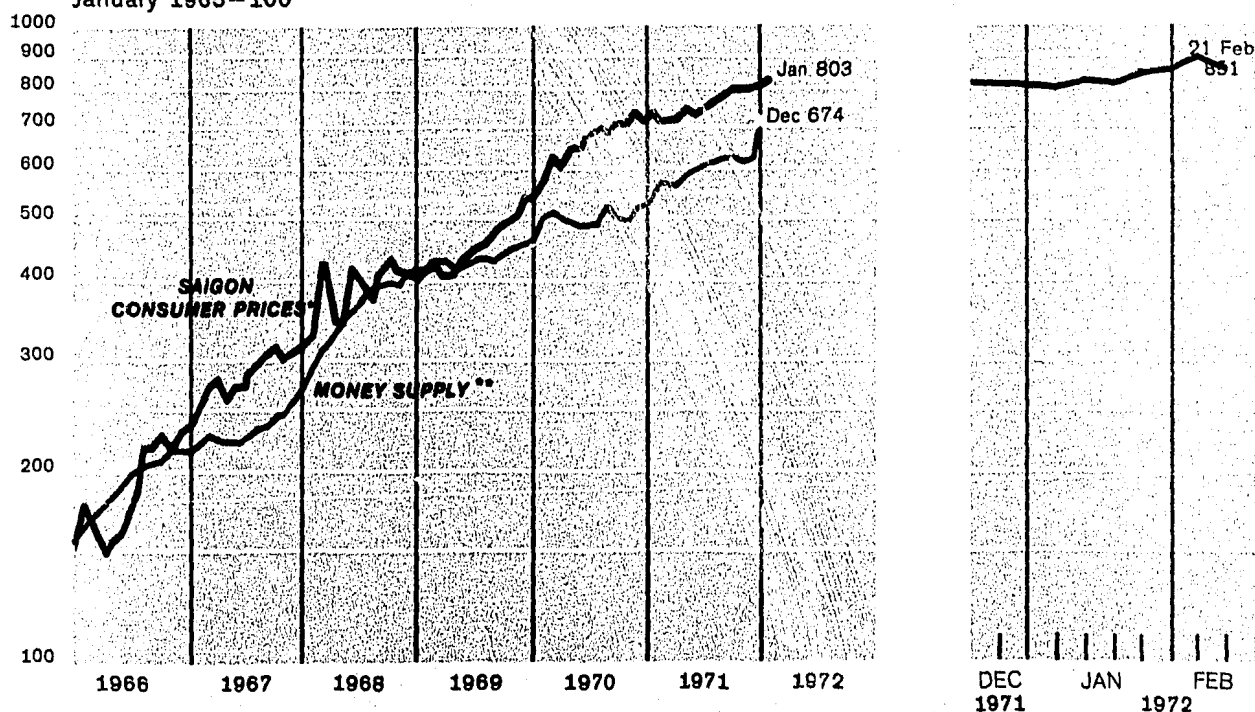
*Excluding holdings of commercial banks

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SOUTH VIETNAM

Indexes of Money Supply and Saigon Consumer Prices

January 1965=100



*USAID monthly average retail price index for Saigon

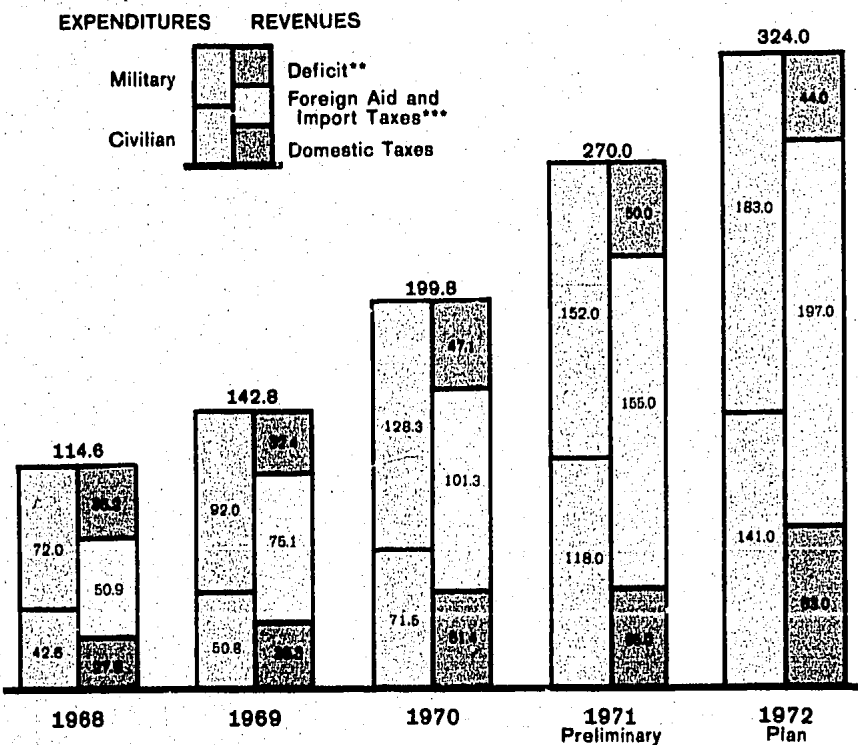
**Data are for end of month

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SOUTH VIETNAM

Government Budget*

Billion Piasters



*Data include extrabudgetary revenues and expenditures.

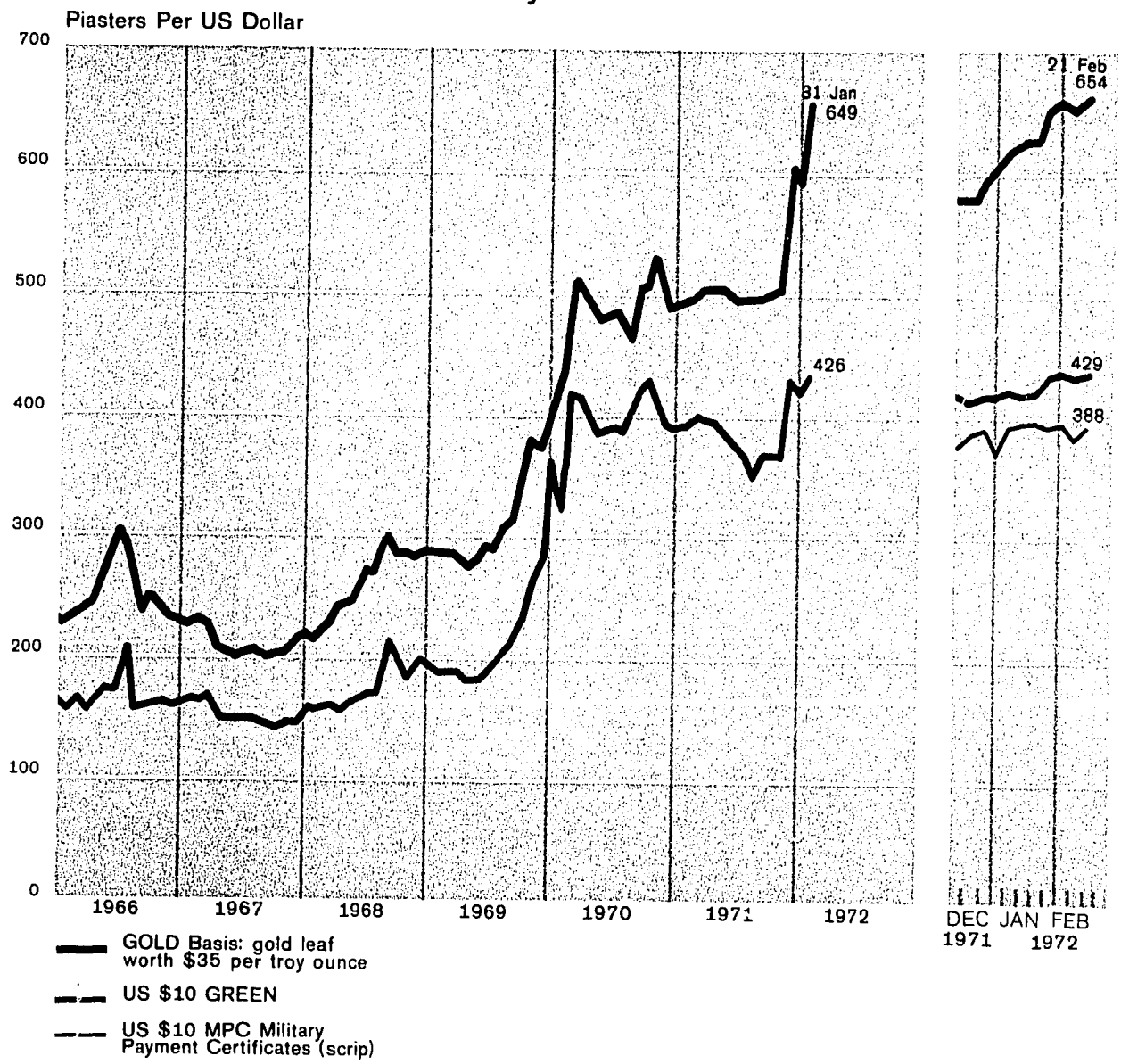
**Residual. Financed primarily by borrowing from the National Bank.

***Includes customs duties and other import taxes, counterpart funds generated by US-financed import programs, and profits from foreign exchange transactions. A major result of the November 1971 reforms was to make explicit a greater share of US aid to the budget that earlier took the form of high customs duties on aid-financed imports.

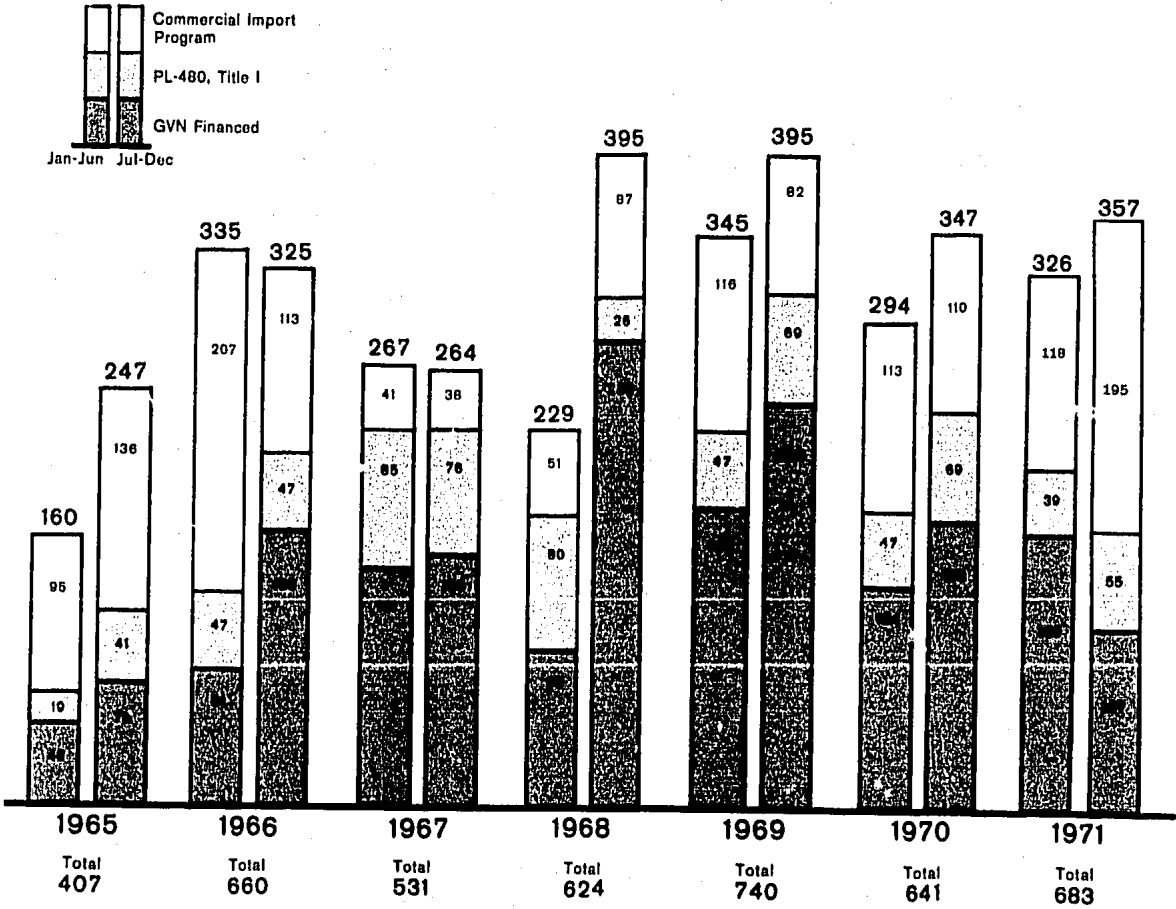
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SAIGON

Free Market Gold and Currency Prices



IMPORT LICENSING
Million US Dollars



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